IN THE

Supreme Court of the United States

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No.

UNITED FINANCE AND THRIFT CORPORATION OF TULSA, Formerly State Loan Company of Tulsa, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

UNITED FINANCE AND THRIFT CORPORATION OF TULSA COUNTY, Formerly The State Loan Company (Oklahoma), *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The above-named petitioners petition for a writ of certiorari to review the judgment of the Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the Tax Court (R. 49-63) is reported at 31 T.C. 278. The opinion of the Court of Appeals (App. A, *infra*, p. 1a) is reported at 282 F. 2d 919.

JURISDICTION

The opinion of the Court of Appeals was entered September 29, 1960 (App. A, *infra*, p. 1a). Petition for rehearing was denied by the Fourth Circuit on November 14, 1960. (App. B, *infra*, p. 8a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

I

A small loan company purchased at face value the accounts receivable of two other small loan companies. In addition, the purchaser, in a separate and severable manner, paid designated amounts for covenants not to compete, one for three years, the other for two years.

The question is: May the purchaser amortize the cost of the covenants over their respective lives?

II

Does a good will value attach to bare accounts receivable which are purchased where the purchaser (a) did not use the name of the seller in any way; (b) did not advertise it was the successor to the sellers; and (c) did not operate in the same location as the sellers, except for about three months that it took to move from the location of one seller?

III

May the Tax Court, without evidence and without explanation, re-do an arm's length purchase and say that only 64.2% of the amount specifically paid for a covenant not to compete was actually paid for the covenant and that the balance was paid for good will? In an identical purchase, except as to amounts, may the Tax Court decide that 49.5% of the amount paid was actually paid for the covenant and the balance paid for good will?

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

"Sec. 23. *Deductions From Gross Income.*

"In computing net income there shall be allowed as deductions:

* * * * * * * *

"(1) [as amended by Sec. 121(c), Revenue Act of 1942, c. 619, 56 S at 798] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

"(1) of property used in the trade or business, * * *

* * * * * * * *

26 U.S.C. 1952 ed., Sec. 23)."

Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939:

"Sec. 39.23 (l)-3. *Depreciation of Intangible Property.*—Intangibles, the use of which in the trade or business or in the production of income is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents

and copyrights, licenses, and franchises. Intangibles, the use of which in the business or trade or in the production of income is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business or in the production of income for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. No deduction for depreciation including obsolescence, is allowable in respect of good will."

STATEMENT

The essenital facts in this case are extremely simple. Petitioner purchased the bare accounts receivable of two small loan companies at face value. In addition the petitioner paid the sellers separate specific amounts in consideration for covenants not to compete in the Tulsa area. One covenant was for three years and the other was for two years. (App. *infra*, pp. 3a-5a)

The petitioner did not use the names of the sellers in any way, did not advertise it was the successor to the sellers and did not operate in the same location, except for about three months that it took to move from the location of one seller. (R. 56)

In the small loan business accounts receivable are renewed on an average of two point six (2.6) times and remains on the books for about 27 to 30 months. (R. 55)

Petitioner amortized the cost of the covenants over their respective lives. The Tax Court, without evi-

dence and without explanation, except that the accounts receivable purchased would earn profits for from 27 to 30 months, held that 49.5% of the purchase price paid in one instance was for the covenant and the balance for good will. In the other purchase 64.2% of the purchase price was attributed by the Tax Court to the covenant and the balance to good will. The Fourth Circuit affirmed.

Petitioner contends that the decision below is in conflict with the established law that where property is purchased and the parties in good faith and realistically treat a covenant not to compete in a separate and severable manner the purchaser may amortize the cost of the covenant over its life.

The facts are fully set forth in the Findings of Fact of the Tax Court (R. 51-58) and in the Court of Appeals opinion. (App. *infra*, pp. 1a-7a) Summarized in more detail than above they are:

Petitioner, a small loan company, in 1950 purchased the accounts receivable of the Royal Loan Company in Tulsa, Oklahoma for their face value of $181,803.00. In addition the petitioner paid the seller $23,397.00 as specific consideration for a covenant not to compete in the small loan business in the Tulsa area for three years.

In 1952 petitioner purchased the small loans accounts receivable of The Bankers Investment Company in Tulsa, Oklahoma for their face value of $26,125.44. In addition, the petitioner paid the seller $4,750.00 as specific consideration for a covenant not to compete in the Tulsa area for two years.

In the small loan business, the typical customer renews or refinances his outstanding loan approximately two point six (2.6) times and on the average remains on the books of the loan company as a borrower for about 27 to 30 months. Both Royal and Bankers had the experience of obtaining repeat business from former borrowers and referral business from friends of former customers.

Petitioner would not have made either of the purchases if the corporate vendors had not agreed to execute the covenants not to compete, included as a separate provision in each of the contracts of sale. After executing said contracts, neither petitioner nor any subsidiaries of its parent corporation advertised that it was the successor of Royal or Bankers nor did it ever use the names of the vendors in any connection with the operation of the small loan business in Tulsa.

After the execution of the contract with Royal petitioner operated at the same location as the vendor for approximately three months until it could move the office to a different location. Royal did not continue in the small loan business in Tulsa after the execution of said contract, but did continue in that business in other localities.

After the execution of the contract with Bankers, petitioner never operated at the same location as the vendor in Tulsa. Bankers did not continue in the small loan business in Tulsa directly or indirectly for two years after the execution of the agreement of October 7, 1952 but did continue in the "sales finance" business in Tulsa after that date. After the expiration of the covenant not to compete, included in the aforesaid contract, Bankers went back into the small loan business in Tulsa.

During the year 1952, the petitioner's parent corporation, State Loan and Finance Corporation, had one subsidiary operating two offices in Tulsa (a large one and a small one) and another subsidiary operating a small office in Tulsa. The two small offices were not operating profitably and it was decided to consolidate them into one office. Consequently, on October 10, 1952 The State Loan Company (Oklahoma) sold and transferred to The State Loan Company of Tulsa all of the remaining assets acquired in the aforesaid purchase of 1950 from Royal.

The State Loan Company of Tulsa appears in the case solely because on October 10, 1952, it took over at cost all the remaining assets acquired in the purchase from Royal. Included among the assets was the unamortized cost of $8,448.59 of the covenant not to compete. The name of this second corporation, on October 10, 1952, was The State Loan Company of Tulsa. In February 1954, its name was changed to United Finance and Thrift Corporation of Tulsa.

For the periods here involved, the petitioners deducted from income the allocable amount of the cost of the covenants not to compete. Also there was a carryback of a net operating loss by The State Loan Company of Tulsa. This carryback issue depends entirely upon the determination of the amortization issue.

The Commissioner, in the notices of deficiency, disallowed the deduction with the explanation that "the claimed amount represented portions of amounts paid for intangible assets which are not subject to amortization."

The Tax Court, without stating the basis for its allocation, held that $11,579.80, or about 49.5% of the total consideration for the covenant, represented the cost of the Royal covenant, and $11,817.20 represented the cost of good will. It held that $3,051.84, or about 64.2% of the total consideraiton for the covenant represented the cost of the Bankers' covenant, and $1,698.16 represented the cost of good will. The Fourth Circuit affirmed. (App. *infra*, pp. 1a-7a)

REASONS FOR GRANTING THE WRIT

(a) The decision below is in direct conflict with the decision of the Tenth Circuit in *Commissioner v. Gazette Telegraph Co.* (1954), 209 F. (2d) 926, 45 AFTR 266. In the *Gazette Telegraph* case the taxpayer purchased all of the capital stock of a corporation which published a newspaper. The purchase price was $750,000.00 for the stock and $250,000.00 for a covenant of the sellers not to compete. The Tenth Circuit said:

> "* * * in a transaction in which property is sold and the seller covenants not to engage in business in competition with the purchaser for a specified period of time, if the parties in good faith and realistically treat the covenant in a separate and severable manner in respect to value and cost the purchaser may amortize the price paid for the covenant and claim annual deductions pro rata during the life of the covenant." (citing cases

In the case at bar no contention was made by the Commissioner and no finding was made by the Tax Court that the transactions here involved were not in good faith and at arm's length. The transactions were between complete strangers. The purchases would

not have been made had the sellers not agreed to execute the covenants not to compete.

The reasoning of the Tax Court and the Fourth Circuit was that because the petitioner expected to make a profit by the loans staying on the books for 30 months an element of good will was purchased. All assets used in a business are purchased in the hope of making a profit. Good will value does not attach to assets because of that hope. The complete purpose of covenants not to compete is to protect expected profits from the business or assets purchased.

(b) The decision below is in direct conflict with the decision of the Seventh Circuit in *Wilson Athletic Goods Mfg. Co.* v. *Commissioner* (1955), 222 F. (2d) 355, 47 AFTR 858. In the *Wilson* case the Court of Appeals allocated a value to a covenant not to compete, although no allocation was made in the contract of purchase. The facts were that the Wisconsin Shoe Company, a partnership, manufactured atheltic shoes and was one of Wilson's suppliers. Wilson purchased the entire business of Wisconsin for a total consideration of $300,000.00. The machinery and fixed equipment, movable equipment, leasehold improvements, molds, lasts, patterns and dies, had a total value of $157,307.70. No value was attributed in the contract of purchase to the covenant not to compete. Wilson's accounting department allocated $132,692.30 of the purchase price to the covenant and $10,000.00 to good will. Wilson continued to operate Wisconsin as a going concern at its old location. Wilson publicly announced the purchase, said that Wisconsin would be operated as a division of Wilson and that its fine products would thus be made available to more players

and teams through Wilson distributors than was possible before. The Tax Court did not allow any deduction with respect to the amortization of the covenant. Despite the "silence of the contract" with respect to the amount paid for the covenant, the Seventh Circuit reversed and permitted the amortization of the $132,692.30 which Wilson had treated as the cost of the covenant.

The Court of Appeals stated (p. 357):

> "Where realistically and actually the covenant has a discernible value, the purchaser, of course, may amortize the price paid for it and claim annual deductions pro rata during the life of the covenant".

(c) The decision below is in direct conflict with the decision of the Second Circuit in *Ullman* v. *Commissioner* (CA 2, 1959), 264 F. (2d) 305, 3 AFTR (2d) 858. In that case all of the capital stock in three linen supply companies were sold to a rival corporation. The contracts provided, as in the case at bar, that a stated consideration was paid for covenants not to compete. The Second Circuit stated:

> "* * * we agree with the Tenth Circuit in their decision in Hamlin's Trust v. C.I.R., (209 F. 2d 761, 45 AFTR 224) that when the parties to a transaction such as this one have specifically set out the covenants in the contract and have there given them an assigned value, strong proof must be adduced by them in order to overcome that declaration. * * *"

(d) In the case of *John W. Rogers and Creta B. Rogers* v. *United States* now pending before the Ninth Circuit, No. 16581 on appeal from the United States

District Court for the District of Nevada, — F. Supp. —, 4 AFTR 2d 5770 the Government contends the law to be as we here contend. The *Rogers* case involves a situation where the plaintiffs owned, as a partnership, the Nevada Finance Company, which conducted a small loan business. In 1953 the partnership sold the entire going business, including all assets and the trade name, to Acceptance Finance Company. A condition of sale was that the plaintiffs would not engage in the small loan business within a radius of seventy-five miles of Reno, Nevada for a period of five years. In addition to paying $283,393.69 for the notes receivable and the tangible assets, $60,900.00 was paid in consideration of the covenant not to compete. The District Court, at the urging of the Government, said that where there is a severable consideration for a covenant, it will be treated as payment for the covenant which means that it is ordinary income to the seller. The Government's brief in the Court of Appeals, which was filed in September, 1960 states (p. 6):

> "* * * As we demonstrate below, the taxpayers' promise not to compete was segregated from the sale of their business and a specific amount was allocated as payment therefor. The payment received for that promise was, therefore, properly treated by the Commissioner as ordinary income."

The Government's brief in the *Rogers* case further states (pp. 12 and 13):

> "In sum, in their negotiations the parties to the sale segregated the promise not to compete and treated it separately from the sale of the business. The contract of sale itself—i.e., the second option—separated the covenant and fixed its value at $60,900.00. (R. 68-69). In fact, the covenant was

so segregated from the sale of the business that payment for it was made by a separate check. (R. 118). In addition, the purchaser amortized the cost of this covenant and deducted that amount on its income tax returns (R. 23, 106), indicating that it was a separate item from the purchase of the business. Clearly, there is more than ample evidence to support the decision below."

The Government cites in its brief, *Ullman* v. *Commissioner*, (CA 2, 1959) 264 F. (2d) 305, 3 AFTR (2) 858; *Commissioner* v. *Gazette Telegraph Company*, (CA 10) 209 F. 2d 926; *Wilson Athletic Goods Mfg. Co.* v. *Commissioner*, (CA 7, 1955) 222 F. (2d) 355, 47 AFTR 858 in support of the same position that we here urge.

The question here involved is important. The financial pages of newspapers almost daily tell of the purchase of businesses by competitors. It is common knowledge that covenants not to compete are required in practically all of these transactions. The public is entitled to know if it can separately negotiate and pay for such covenants or whether a Tax Court judge can remake the deal. Uncertainty in fax law is always a detriment to business and to the revenue.

II.

The decision below is in conflict with the established law as to the meaning of "good will." The Tax Court and the Fourth Circuit held that good will attaches to accounts receivable which were purchased separately from a going business. The name of the seller was never used, the purchaser never advertised it was the successor to the sellers and, except for a three month period it took to move, the purchaser did not operate in the same location as the sellers.

The definition of good will was long ago established by this Court in *Metropolitan Bank* v. *St. Louis Dispatch Co.* (1893), 149 U.S. 436, 446:

> "Undoubtedly, good will is in many cases a valuable thing, although there is difficulty in deciding accurately what is included under the term. It is tangible only as an incident, as connected with a going concern or business having locality or name, and is not susceptible of being disposed of independently. Mr. Justice Story defined good will to be 'the advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessity, or even from ancient partialities or prejudices.'"

To say that good will exists in a situation such as the case at bar goes far beyond any known judicial definition of the term. Accounts and notes receivable are bought and sold daily in transactions involving banks and other financial institutions. Premiums are frequently paid. The rule is that the premiums are to be amortized over the life of the loans. See § 171 Internal Revenue Code of 1954. To deny amortization on the ground that an element of good will attaches to purchased accounts receivable can have a serious detrimental effect on financial transactions.

As the accounts receivable would go off the books in from 27 to 30 months, it would seem that their cost should be recovered in that period under the provision

of the regulations which states, (Regulations 118, Sec. 39.23(1)-3):

> "* * * If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business or in the production of income for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. No deduction for depreciation, including obsolescence, is allowable in respect of good will."

III

The decision below is in conflict with the established law that a trier of facts must base his findings on credible evidence and not make guesses.

In the case at bar, the Tax Court said that 64.2% of the amount paid for the covenant in the Bankers' purchase was attributable to the covenant and the balance to good will. In the Royal purchase, the Tax Court held that 49.5% of the amount paid for the covenant was attributable to the covenant and the balance to good will. The Tax Court gave no hint as to how it arrived at the figures and there is not an iota of proof to justify such figures.

The decision of the Court below in affirming the Tax Court is in conflict with the decision of the Ninth Circuit in *Union Stock Farms, et al, v. Commissioner* (1959), 265 F. 2d 712, 3 AFTR 2d 952 reversing 155, 308, P-H Memo T.C. which involved a situation where the Tax Court made an allocation between capital expenditures and expenses. The Ninth Circuit states (p. 961):

"We have carefully examined the evidence introduced on this issue and find no support for the roughly fifty per cent split between capital expenditures and recurring expenses, as made by the Tax Court. It is a guess without factual support."

It further states (p. 962):

"Here we find no credible evidence to support the allocation made by the Tax Court. Nor can we come to a conclusion on it, save by inference and guesswork. We are thus required to remand the matter for additional hearings, and the introduction of further evidence on this limited issue."

The decision of the Court below is also in conflict with the decision of the Second Circuit in *Commissioner* v. *Chatsworth Stations, Inc.*, (1960) 282 F. 2d, 132, 6 AFTR 2d 5243. The Second Circuit states:

"* * * We find nothing to indicate how the Tax Court determined the amount the taxpayer paid for the good will of the stations as distinct from the amount it paid for the land, buildings and equipment, and intangibles other than good will; and therefore we are required to remand the case for further findings."

The question here involved is important and should be resolved. Unless courts follow rules of proof, the only result will be additional litigation to be handled by our already overburdened courts.

CONCLUSION

1. The case is important to the business and financial world. If businessmen cannot negotiate in good faith at arm's length for covenants not to compete, and amortize the cost of the covenants over their lives, it can have a serious detrimental effect upon business

and upon the revenue. This case is in conflict with many courts of appeals. Certiorari should be granted to resolve the conflict.

2. The Court below has announced that the purchase of bare accounts receivable include the purchase of an element of good will. Such a rule is in conflict with the long-established decisions of this Court on the nature of good will. The rule of this case could have an adverse effect upon business transactions involving the purchase and sale of accounts and notes receivable and other commercial paper. The conflict with established law should be resolved.

3. The Tax Court made a pure guess without any evidence to support its findings that 64.2% of the negotiated cost of the covenant was attributable to the covenant in the Bankers purchase and 49.5% was attributable to the covenant in the Royal purchase. In affirming the Tax Court, the Fourth Circuit is in direct conflict with other circuits which hold that findings of the Tax Court must be based on credible evidence. If this case stands the Tax Court can be expected to continue to guess instead of basing findings on the evidence. This can only lead to more appeals to the Court of Appeals. The conflict should be resolved.

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February, 1961

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 8093

UNITED FINANCE AND THRIFT CORPORATION OF TULSA, Formerly The State Loan Company of Tulsa, and UNITED FINANCE AND THRIFT CORPORATION OF TULSA COUNTY, Formerly The State Loan Company, (Oklahoma), *Petitioners*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petitions to Review the Decisions of the Tax Court of the United States

(Argued June 7, 1960 Decided September 29, 1960)

Before SOPER and HAYNSWORTH, Circuit Judges, and CHARLES F. PAUL, District Judge

Robert Ash (Ash, Bauersfeld & Burton on brief) for Petitioners, and John J. Pajak, Attorney, Department of Justice, (Charles K. Rice, Assistant Attorney General, Lee A. Jackson and Harry Baum, Attorneys, Department of Justice, on brief) for Respondent.

CHARLES F. PAUL, District Judge:

These are consolidated petitions for review of decisions of the Tax Court[1] disallowing, in part, deductions claimed by the taxpayers on account of depreciation. The taxpayers claimed in the Tax Court, and here insist, that they are entitled to deductions as "new business development expense" of the full amounts of sums which they say were paid solely as consideration for "covenants not to compete" obtained from the sellers, in connection with the

[1] 31 T.C. 278. Comm. Acq. 1959-1 Cum. Bull. 5.

purchase of certain business assets, by amortizing those sums over the duration of the covenants. The taxpayers claimed these deductions under applicable portions of Sec. 23 Internal Revenue Code of 1939,[2] and Sec. 39.23(l)-3 of the Treasury Regulations 118.[3] The Commissioner took the position before the Tax Court that the payments were, in substantial part at least, payment for intangible values, in the nature of good-will, which are not depreciable; that, insofar as the sums included any payment for a covenant not to compete, there was no basis for severability of that part and that the deductions should be denied in toto. The Tax Court decided that the sums paid were partly in consideration of the covenants not to sue and partly in consideration of assets in the nature of good-will. The Tax

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[2] In computing net income there shall be allowed as deductions:

• • • • •

(l) [as amended by Sec. 121(c), Revenue Act of 1942, c. 619, 56 Stat. 798] Depreciation.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, • • •

• • • • •

(26 U.S.C. 1952 ed., Sec. 23.)

[3] "Depreciation of Intangible Property.—Intangibles, the use of which in the trade or business or in the production of income is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses, and franchises. Intangibles, the use of which in the business or trade or in the production of income is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business or in the production of income for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. No deduction for depreciation, including obsolescence, is allowable in respect of good will."

Court did, however, find some basis for severability and allowed the taxpayers substantial parts of their claimed deductions and denied the rest. The action of the Tax Court resulted in judgments determining deficiencies in the amount of $1,477.47, for the fiscal year ended September 30, 1953, against the petitioner, United Finance & Trift Corporation of Tulsa, and of $2,624.32 for the calendar year 1952 against the petitioner, United Finance & Trift Corporation of Tulsa County.

To trace the corporate genealogy of the petitioners, the various name changes through which they have gone, and the intercorporate assignments, can only serve to confuse. It is sufficient to state that both the petitioners are wholly-owned subsidiaries of State Loan & Finance Company, a Delaware corporation, with its principal offices in Washington, D. C. The parent corporation operates, through various subsidiaries, about one hundred eighty-five "small loan" offices in about nineteen to twenty States. The petitioners are both Oklahoma corporations which did business under the Oklahoma Small Loans Statutes in the City of Tulsa. We will distinguish between them by calling the one simply "Tulsa" and the other "Tulsa County".

On November 1, 1950, Tulsa County purchased all of the subsisting loan accounts of the Tulsa office of Royal Loan Company, which company was unrelated to Tulsa County, and secured from Royal a covenant not to compete with Tulsa County by engaging in the busines of making loans in the amount of $300.00 or less in Tulsa for three years. The pertinent provisions of the contract are set forth in footnote.[4] Under the contract, the sum of $181,803.00

[4] "That in consideration of the payment by the Purchaser to the Seller of the sum of $181,803.00, • • • the Seller, hereby sells, asigns, transfers and conveys to the Purchaser, • • •

"All loan accounts, indebtedness of borrowers, notes, promises to pay and other obligations secured and described in Exhibit "A" attached hereto and made a part hereof, including all

the full unpaid balance of the purchased notes was paid for the notes and the additional sum of $23,397.00 was paid for the expressed consideration of the covenant not to sue. In its subsequent dealings with the former customers of Royal, Tulsa County made no use of Royal's name. It occupied the office formerly used by Royal for a period of about three months, until the office could be transferred elsewhere. For tax purposes, Tulsa County immediately began amortizing the sum of $23,397.00 on its books as a deductible item accruing from a depreciable covenant not to compete.

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claims, choses in action, bills of sale to secure debt, chattel mortgages, liens, pledges and other instruments and security of every kind and nature in any way pledged, assigned, mortgaged or hypothecated to the Seller as security for or in any manner securing or collateral to the said loans or any of them and including all papers, records, cards and any other documents in connection with said loans, including all notes, promises to pay and other obligations and papers in connection with said accounts; all records cards and lists of former borrowers and all papers and documents of every kind pertaining to said former borrowers, and any and all other papers, documents of any kind pertaining to the present and former borrowers of this office.

In consideration of the further payment by the Purchaser to the Seller of the sum of $23,397.00, receipt of which is hereby acknowledged, the Seller hereby specifically agrees that it will not, for a period of three (3) years from the date hereof, engage or be interested, directly or indirectly in the business of making loans in the amount of $300.00 or less and loans under a discount plan in the amounts of $2500.00 or less in the City of Tulsa, Oklahoma or in any other town, village, city or locality within fifteen (15) miles of said city, whether such business be actually conducted within such place or conducted from without such place, and during said period, the Seller hereby specifically agrees that it will not in any manner be interested, directly or indirectly, in any loan account or any person any of which indebtedness, borrower's notes, promises to pay, or other obligations are hereby sold, assigned or transferred to the Purchaser.

On October 7, 1952, Tulsa County entered into a similar agreement under which it purchased all of the loan accounts of another small loan company, Bankers Investment Company, with reference to its Tulsa office, and secured its covenant not to compete for a period of two years. In this agreement it was stipulated that $26,125.54 was being paid for the loan accounts, and $4,750.00 on account of the covenant not to compete. Tulsa County immediately began to depreciate this latter sum.

On October 10, 1952, Tulsa County assigned to "Tulsa" all the remaining balances of the loan accounts it had purchased from Royal, including the unamortized cost attributed to the covenant not to compete by Royal, which was stated to be $8,448.59. "Tulsa" undertook to amortize and deduct this latter amount in determining its taxable income.

In the Tax Court, the taxpayers admitted that it was their experience in the small loan business that borrowers do not meet their obligations on time; that this results in the necessity for "refinancing" by extending another loan over a longer period of time, and that, on the average, a borrower remains on their books with respect to the original amount borrowed for a period of two and one-half years. Taxpayers further admitted that this "refinancing" is profitable, and that its prospect was one of the main reasons why they were willing to pay more than the face amount of the book obligation in order to acquire another loan company's current accounts. The taxpayers insisted that their requirement of a covenant not to compete was, in the main, for the purpose of protecting this "refinancing" value from the possibility of pirating by the selling loan company. Officials of both Royal and Bankers testified that they had also experienced repeat or new business from former borrowers and also new business from customers referred to them by former borrowers.

In this state of the record, we cannot say that the findings of the Tax Court that the extra payment included values in the nature of good-will or "going concern" values are not supported by substantial evidence or that they are clearly erroneous.

The taxpayers rely heavily upon *Commissioner of Internal Revenue* v. *Gazette Tel. Co.*, (10th Cir. 1954) 209 F. 2d 926. In this case, the purchasers of corporate stock from individual shareholders, who were the principal executives and officers of the corporation which issued the stock, required of the sellers covenants not to compete with the buyer for a period of ten years. In the agreement of sale, the values attributable to the stock and to the covenant not to compete were separately stated. The Tax Court found that the parties, in good faith and realistically, treated the covenant in a separate and severable manner in respect to value, and held that the taxpayer could amortize and deduct pro rata the amount thus stated over the life of the covenant not to compete. The Commissioner did not even contend that these findings of fact were not supported by substantial evidence, and, understandably, the Appeals Court affirmed.

The taxpayers contend that the "elements of good-will" found by the Tax Court in this case do not fit within any judicially expressed definition of the term "good-will", and they cite *Grace Bros., Inc.* v. *Commr.*, 173 F. 2d 170, as enumerating five essential elements of good-will, several of which are missing in this case. We do not read the Grace case as holding that all of these elements must be present. With a small loan company, its borrowers are its customers. If its business is to continue, relationships and dealings with those customers are essential. Its stock in trade is the sum total of the choses in action which it holds, representing the obligations of its customers to it. When more than the face amount of those choses in action is paid by a purchaser, who expects to continue the small

loan busines through dealings with those customers, evidence of good-will value can be looked for. That evidence was found here.

In *Estate of F. G. Masquelette* v. *Commr.*, (5th Cir. 1956), 239 F. 2d 322, the Tax Court had held that an amount separately stated as being for a covenant not to sue, in connection with the sale of partnership interests in an accounting firm, should be given effect, and that no elements of good-will were present in the purchase, principally because the contract stated that the purchasers were not to use the name of the selling partnership and the business of accounting was a highly personal one. The taxpayer in that case was contending that good-will was involved, and he secured a reversal of the Tax Court by the Court of Appeals under a set of facts which bears strong resemblance to the facts here.

The Tax Court in this case found that the separate consideration paid by the purchasers were partly for intangible assets, in the nature of good-will or going-concern value, and partly for the convenants not to compete. In the absence of satisfactory evidence of the exact values attributable to each of these elements, the Tax Court undertook to allocate values according to its best judgment under the principles of *Cohan* v. *Commr.*, 39 F. 2d 540 (2d Cir. 1930). In the Royal purchase, it assigned 49.5% of the specified consideration to the covenant not to sue, and the balance to good-will. In the Bankers case, it allocated 64.2% of the specified consideration to the covenant not to sue, and the balance to good-will. Taxpayers bitterly complained that there was no justification or basis for this allocation. If this question had arisen upon a petition to review by the Commissioner, it might well have been a troublesome one. The taxpayers here are the beneficiaries of the Tax Court's lenieney in this respect and are in no position to complain.

The decisions of the Tax Court are affirmed.

APPENDIX B

(Filed Nov. 14, 1960)

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 8093

UNITED FINANCE & THRIFT CORPORATION OF TULSA,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Order Denying Petition for Rehearing

The petition for rehearing in this case filed on behalf of the United Finance & Thrift Corporation of Tulsa has been read and considered and the same is hereby overruled.

November , 1960.

MORRIS A. SOPER
United States Circuit Judge

CLEMENT F. HAYNSWORTH, JR.
United States Circuit Judge

CHARLES F. PAUL
United States District Judge

A true copy, Teste:

RICHARD N. F. WILLIAMS, JR.
Clerk, U. S. Court of Appeals for the Fourth Circuit.

By MARGARET L. DAVIS
Deputy Clerk